Monthly Bulletin of Economic Trends

November-December 2022

Business situation significantly worsening, expectations uncertain
Results of the Business Climate Survey of IEER of October 2022

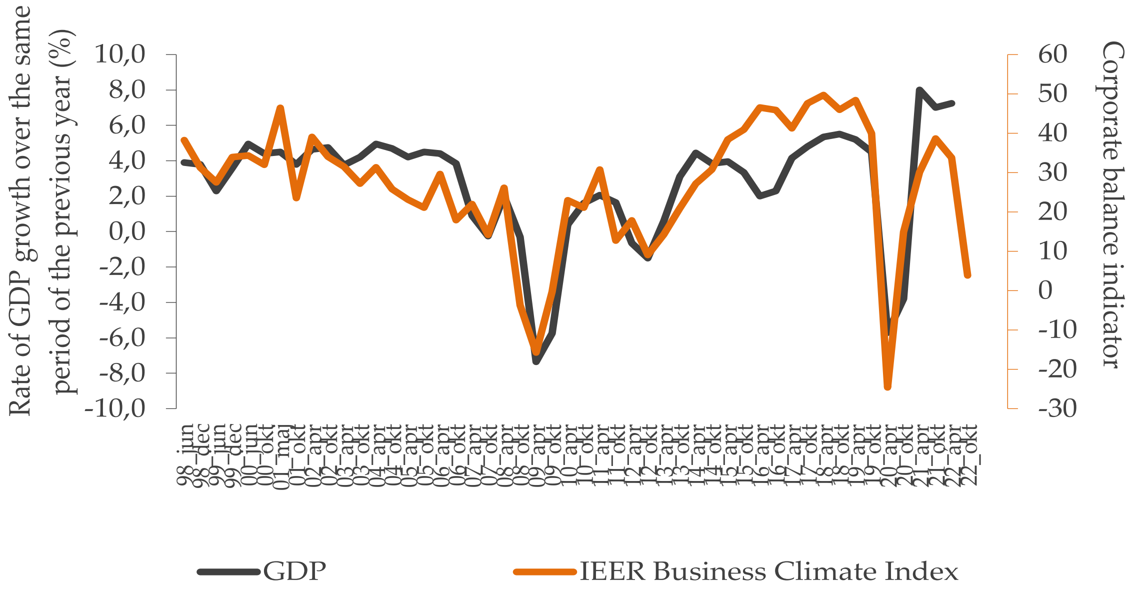
The October Business Climate Survey of IEER is based on the answers of 2,135 CEO respondents. The data was collected between 1 and 31 October. The purpose of IEER's Business Climate Survey was to map the current short-term business expectations of CEOs based on their subjective assessment of the situation and the information available to them at the time of the survey.

In October, the IEER Business Climate Index fell from +34 points in April to +4. The index has essentially recovered from -25 points measured in April 2020, the lowest since records began in 1998, to pre-pandemic levels (+40 points in October 2019) in a year and a half, but it has been in a significant decline once again in the second half of 2022.

The Uncertainty Index increased since April 2022 and currently stands at 59 points. This suggests that the situation of Hungarian enterprises is being assessed in an increasingly polarised way, i.e. there are significant differences in the business situation assessment of companies with regard to the categories they belong to.

The 30-point decline in the Business Climate Index between the first and second halves of 2022 is of the same magnitude as that between April and October 2008 (when the indicator fell from +26 to -4). Since records began in 1998, there was only one instance of a larger semi-annual decline than the one at hand, between October 2019 and April 2020, at the outbreak of the pandemic. The current value of the index (+4 points) is only higher than the indices calculated during the two greatest shocks since records started, i.e. the 2008 global economic crisis and the 2020 COVID-19 pandemic, and it has been the lowest in the period ever since. The current Business Climate Index is close to the +9 points recorded in October 2012, when the second downturn following the 2008 crisis occurred.

Figure 1.: GDP and IEER Business Climate Index



	Oct. 2020	Apr. 2021	Oct. 2021	Apr. 2022	Oct. 2022
GDP	-3.8	8.0	7.0	7.3	
IEER Business Climate Index	14.9	30.1	38.7	33.8	3.9

Source: *HCSO, IEER 2022*

Notes: *GDP data – seasonally and calendar-adjusted, balanced data reported six-month growth rates (the same period of the previous year = 0)*

GDP: left axis; IEER Business Climate Index: right axis

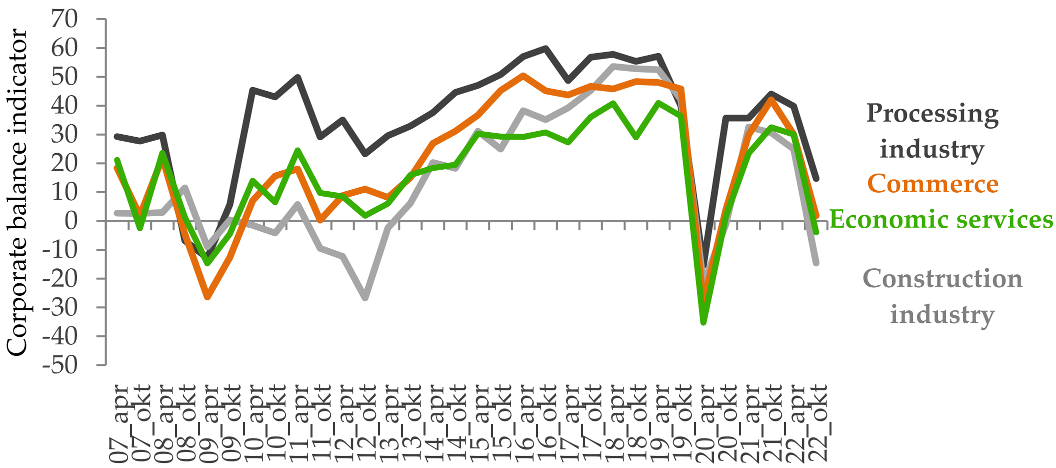
IEER Business Climate Index by company features

The Business Climate Index was highest for manufacturing firms (+15 points), while it scored +2 points for commerce, -4 points for services and -15 points for construction. The most significant shift compared to the previous half was in construction, where the indicator fell by 40 points compared to April. The services sector has seen a 34-point decrease since April, while the commerce sector and the manufacturing sector decreased by 28 points and 25 points respectively.

Taking a look at firms' ownership structure one can see that the Business Climate Index was significantly higher for (partially) foreign-owned firms (+24 points) compared to domestic firms (-7 points). Compared to the previous half, the Business Climate Index decreased by 16 points for companies of (partially) foreign ownership and by 36 points for fully domestic companies.

By exporting activity, the Business Climate Index is lower among non-exporters (-7 points) than among minor exporters (+4 points) and major exporters (+21 points). The indicator decreased by 35 points for minor exporters, 31 points for non-exporters and 22 points for major exporters compared to the previous half.

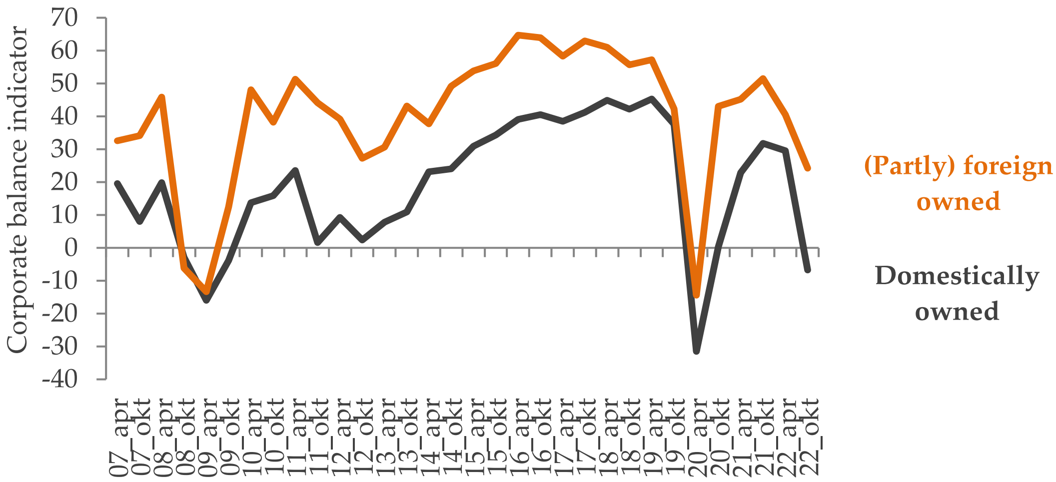
Figure 2.: IEER Business Climate Index by economic sector



Source: IEER 2022

***Please note that** the score in the figure is a balance indicator projected on a scale of 100. In all cases, the balance indicator shows the difference between the rate of companies providing positive and negative situation reports. The indicator therefore spans a scale from -100 to +100. -100 indicates that all of the surveyed companies assessed their situations to have been negative, while +100 indicates that all of the surveyed companies assessed their situations to have been positive.*

Figure 3.: IEER Business Climate Index by ownership structure



Source: IEER 2022

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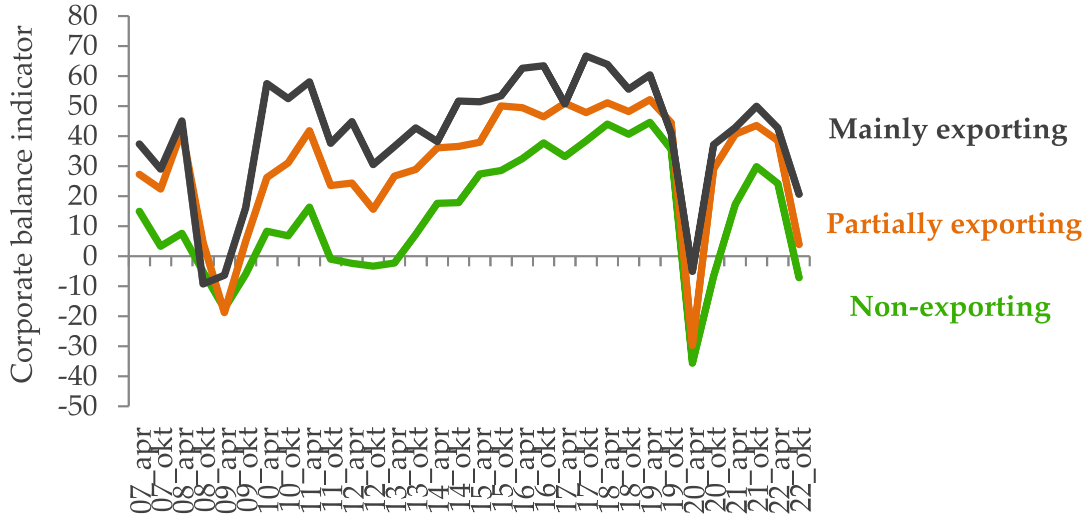
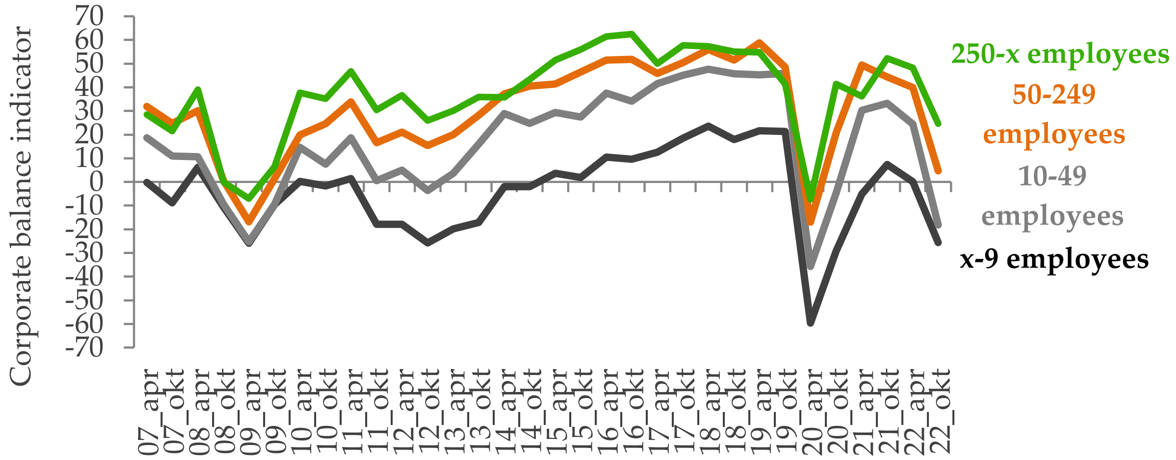
Figure 4: IEER Business Climate Index by export activity



Source: IEER 2022

Please note that *the score in the figure is a balance indicator projected on a scale of 100. In all cases, the balance indicator shows the difference between the rate of companies providing positive and negative situation reports. The indicator therefore spans a scale from -100 to +100. -100 indicates that all of the surveyed companies assessed their situations to have been negative, while +100 indicates that all of the surveyed companies assessed their situations to have been positive.*

Figure 5: IEER Business Climate Index by the number of employees



Source: IEER 2022

Please note that *the score in the figure is a balance indicator projected on a scale of 100. In all cases, the balance indicator shows the difference between the rate of companies providing positive and negative situation reports. The indicator therefore spans a scale from -100 to +100. -100 indicates that all of the surveyed companies assessed their situations to have been negative, while +100 indicates that all of the surveyed companies assessed their situations to have been positive.*

The analysis by company size shows that firms' expectations have deteriorated significantly in all size categories. The Business Climate Index stands at -26 points for firms with fewer than 10 employees, -18 points for 10-49 companies, +5 points for 50-249 companies and +25 points for 250+ large companies. Over the past six months, the Business Climate Index has fallen by 43 points in the 10-49 employee category, 35 points in the 50-249 employee category, 26 points in the 0-10 employee category and 24 points in the 250+ category compared to April.

The significant deterioration in the perception of the business climate (similar to the one that occurred in the aftermath of the 2008 global economic crisis) is a general trend across all business segments surveyed, but the assessment of the current situation still varies widely with regard to company features. The most favourable business climate in the current environment is expected by large companies, (partially) foreign-owned firms, major exporters and industrial companies. In contrast, the Business Climate Index scored negative for firms with fewer than 50 employees, firms that sell exclusively to the domestic market, fully domestic companies, construction businesses and service providers, suggesting expectations of a recession in these segments.

The current assessment of the business climate in all the categories studied was only more positive than in the periods of the two greatest shocks since records began 1998, i.e. the 2008 global economic crisis and the 2020 COVID-19 pandemic. Not counting the first and second waves of the COVID-19 pandemic, the last time firms gave a similar assessment of their outlook prior to the current wave of data collection was in 2012, during the second downturn after the 2008 global economic crisis.

Economic forecasts for the European Union and the Eurozone

The Hungarian economy is significantly influenced by the economies of the European Union member states, which are Hungary's most important trade partners. This article is a summary of forecasts on the European economy (EU27, Eurozone) in 2023, done by the European Commission and various economic research institutes.

All of the latest forecasts for this year and the next are subject to a high degree of uncertainty, as it remains to be seen how long the Russo-Ukrainian war and the ensuing energy crisis will last, while most countries are struggling with accelerating inflation and slowing economic growth.

Economic forecasts presented in the analysis

Forecaster	Geogr. area	Referenced indicators
European Commission	EU-27, Eurozone	GDP, unemployment, central budget deficit, inflation
OECD	Eurozone	GDP, inflation, unemployment rate
IMF	EU-27, Eurozone	GDP
Kopint-Tárki	EU-27, Eurozone	GDP, unemployment, central budget deficit, inflation

After an uninterrupted growth period between 2013 and 2019 in the European Union and the Eurozone, the EU and global economies were hit hard by the coronavirus pandemic in 2020. The European economy suffered a historic downturn in the first half of that year due to the restrictions implemented to contain the pandemic, and although the third quarter (summer 2020) saw an economic recovery, the subsequent second wave in the autumn brought severe disruption and the continent's economy went back into recession. By late 2020 and early 2021, the downturn was less severe than at the outbreak, as businesses and households were better able to adapt to the constraints of the pandemic and typically received strong government support to address the economic challenges. In late 2021 and early 2022, with inflation rising across the continent, economic growth in the EU slowed and Russia's war against Ukraine in February 2022 and the resulting energy crisis further exacerbated the negative effects on the EU economy, sending it on a lower growth and higher inflation path.

According to the **European Commission's autumn 2022 economic forecast**[1] , the EU's economy is at a turning point: rising energy, food and other commodity prices will lead to a soaring inflation hitting the world economy, which is still recovering from the economic

[1] https://economy-finance.ec.europa.eu/economic-forecast-and-surveys/economic-forecasts/autumn-2022-economic-forecast-eu-economy-turning-point_en (Last downloaded: 28/11/2022)

consequences of the coronavirus pandemic. The EU is one of the most vulnerable economies because of its geographical proximity to a war zone and its dependence on imports of fossil fuels. Although real GDP growth in the first half of the year was higher than expected owing to the recovery in demand following the outbreak, growth was weaker in the third quarter and now the erosion of household purchasing power has changed consumer sentiment dramatically and confidence in the business sector has also fallen sharply. Although the growth figures for 2022 are expected to be better than previously forecast, the outlook for 2023 is much less favourable for growth and more pessimistic for inflation than in the European Commission's latest summer interim forecast.

Against this backdrop, the Commission expects economic growth in the EU-27 to be 3.3% this year (the lowest in Estonia at -0.1% and the highest in Ireland at 7.9%) and 3.2% in the Eurozone, about half a percentage point higher than the summer forecast. However, the recession is expected to hit the EU economy in the fourth quarter of 2022 and the first quarter of 2023, with economic growth projected to return to Europe only next spring as the squeeze on inflation gradually eases. For 2023 as a whole, the Commission forecasts a growth of 0.3 percent for the EU-27 and the Eurozone, and even for 2024, GDP will only increase by 1.6 and 1.5 percent respectively. In the year 2023, Germany, Sweden and Latvia could be hit by recession, while Romania, Malta and Ireland could see the highest growth.

Accelerating and widening price pressures in the first ten months of the year have pushed the expected inflationary peak to the fourth quarter this year, and raised the annual inflation forecast to 9.3% for the EU-27 and 8.5% for the Eurozone. As the summer hike in wholesale energy prices makes its way into retail markets, energy inflation is expected to rise until the end of the year and then start to fall next year. However, the impact of fiscal measures to protect households from soaring energy prices adds some uncertainty to the energy inflation forecast. Pressure from the side of food prices will also ease, in line with signals from agricultural commodity markets, but as energy is a key input for much of economic activity, past price increases will now spill over to other components of inflation. Average inflation will remain high in 2023, at 7 percent in the EU and 6.1 percent in the Eurozone, and will not reach 3 percent until 2024.

At the same time, the unemployment rate is at a record low and the employment rate is at a record high. Moreover, vacancy rates and reported labour shortage remain very high, although they have started to decline. Labour demand will respond to the slowdown in economic growth with a delay: vacancy rates and labour shortages are expected to fall significantly before employment starts to decline. The unemployment rate is thus projected to rise only slightly from its historic low of 6.2 percent in 2022 to 6.5 percent in 2023, before falling again to 6.4 percent in 2024. Wages rose at an above-average pace in 2022. This acceleration could stay with us in 2023, but below the inflation rate.

With weakening economic activity, rising interest expenditures and new discretionary measures extended or introduced by governments to mitigate the impact of high energy prices, the EU's aggregate general government deficit will rise again in 2023, but only by about 0.2 percentage point or so, to 3.6 percent of GDP. In 2024, the EU's aggregate deficit is projected to fall to 3.2 percent, due to a projected rebound in economic growth.

However, the Commission's report underlined that there is a high degree of uncertainty surrounding the adjustment of the EU and the global economy to counter a rapid succession of two extreme shocks. The main risk is that the gas market could develop unfavourably, especially in the winter of 2023/2024. Beyond the gas sector, the EU is also directly and indirectly exposed to new shocks to commodity markets stemming from geopolitical tensions. The emergence of a wage-price spiral fuelling high inflation remains an important risk factor, as well as the potential disorderly adjustment to the new high interest rate environment in financial markets. Both are amplified by the potential conflict between fiscal and monetary policy objectives. Health risks related to pandemics remain, although these would mostly affect the EU indirectly through supply and demand channels, while the adverse impact of climate change appears to increase the risks to the EU and the global economy.

According to the **OECD's forecast**[2] published in November, the world economy is experiencing the worst energy crisis since the 1970s, but the resulting global slowdown will hit economies unevenly, with Europe bearing the brunt as Russia's war in Ukraine both affects business and drives up energy prices, while Asia could be the engine of growth. The organisation forecasts that the eurozone economy will slow from 3.3 percent growth this year to 0.5 percent next year, before expanding by 1.4 percent in 2024. The OECD expects inflation in the eurozone to reach 8.3 percent this year and 6.8 percent next year.

The **International Monetary Fund (IMF) forecasts** a growth of 3.1% in the Eurozone and 3.2% in the EU in 2022, which is 0.3 percentage point higher than in the summer. It expects growth to slow significantly to 0.5-0.7 percent in 2023.[3]

[2] https://www.oecd-ilibrary.org/docserver/f6da2159-en.pdf?expires=1669804627&id=id&accname=guest&checksum=04EEE7E6EBAD6933556005BD34DC6F15 (Last downloaded: 30/11/2022)

[3] https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/EURO/EU (Last downloaded: 29/11/2022)

The October 2022 GDP forecast of the **Kopint-Tárki** Konjunktúrakutató Intézet Zrt.[4] forecasts a 2.8 percent growth for the EU-27 and the Eurozone this year, but growth may slow to 0.5 and 0.3 percent next year. The report adds that for the time being it is assumed that the situation will not deteriorate to the point where the European economy goes into recession next year and that energy supply problems will remain manageable. However, high inflation, especially in some central and eastern European countries, will put a brake on growth and the recovery is expected to be a slow and painful process.

EU-27 and Eurozone GDP forecasts for 2022

Forecaster	EU 27	Eurozone
European Commission	3,3%	3,2%
OECD	--	3,3%
IMF	3,2%	3,1%
Kopint-Tárki	2,8%	2,8%

[4] https://kopint-tarki.hu/wp-content/uploads/2022/10/Konjunkturajelentes_2022_3_20221012.pdf (Last downloaded: 28/11/2022)

Profitability trends of Hungarian enterprises

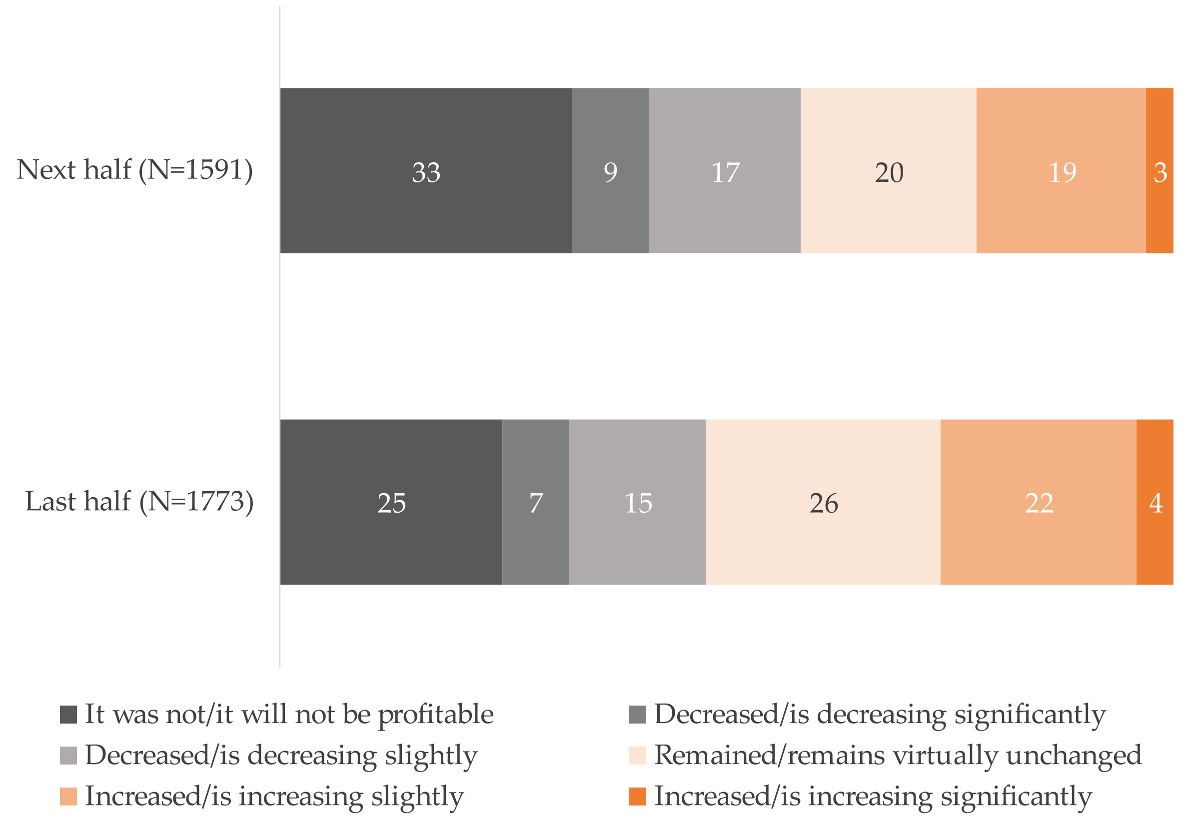
Based on the results of the latest, October 2022 semi-annual business climate survey conducted by the HCCI Institute of Economic and Enterprise Research (IEER), this analysis examines the profitability of Hungarian businesses in the past six months and expectations for the next half. The October 2022 survey took answers from 2 135 CEO respondents. The sample of responding companies is representative in terms of contribution to GDP by region and number of employees. Due to weighting, the distributions calculated in the analysis do not reflect the basic distributions of respondents, but their distributions with regard to their economic weight.

The profitability of company activity

In our questionnaire survey, we asked business leaders about the past and future profitability of their main business activity. In general, expectations for the next six months are clearly more pessimistic than for the last six months. In addition, the managers surveyed were significantly less likely to answer questions about future profitability than questions about profitability in the past half.

Based on the responses from business leaders a quarter of businesses did not make a profit in the last six months. Respondents are more pessimistic about the future, with a third of them saying that they do not expect their business to be profitable in the next six months. Over the next six months, 26 percent of businesses expect profitability to fall compared to the period of October 2021 to April 2022, while 22 percent reported a significant or slight fall in profitability over the last six months compared to the same period in 2021. A fifth of respondents expects profitability to remain unchanged in the next six months, up from 26 per cent for the past six months. 22 percent of managers expect profitability to increase, while 26 percent reported a small or significant increase in profitability over the past six months. Overall, a higher proportion of businesses expect profitability to fall or change negatively in the upcoming six months compared to the last six months (Figure 1).

Figure 1: Profitability of the main activity of the enterprise (percent)



Source: IEER 2022

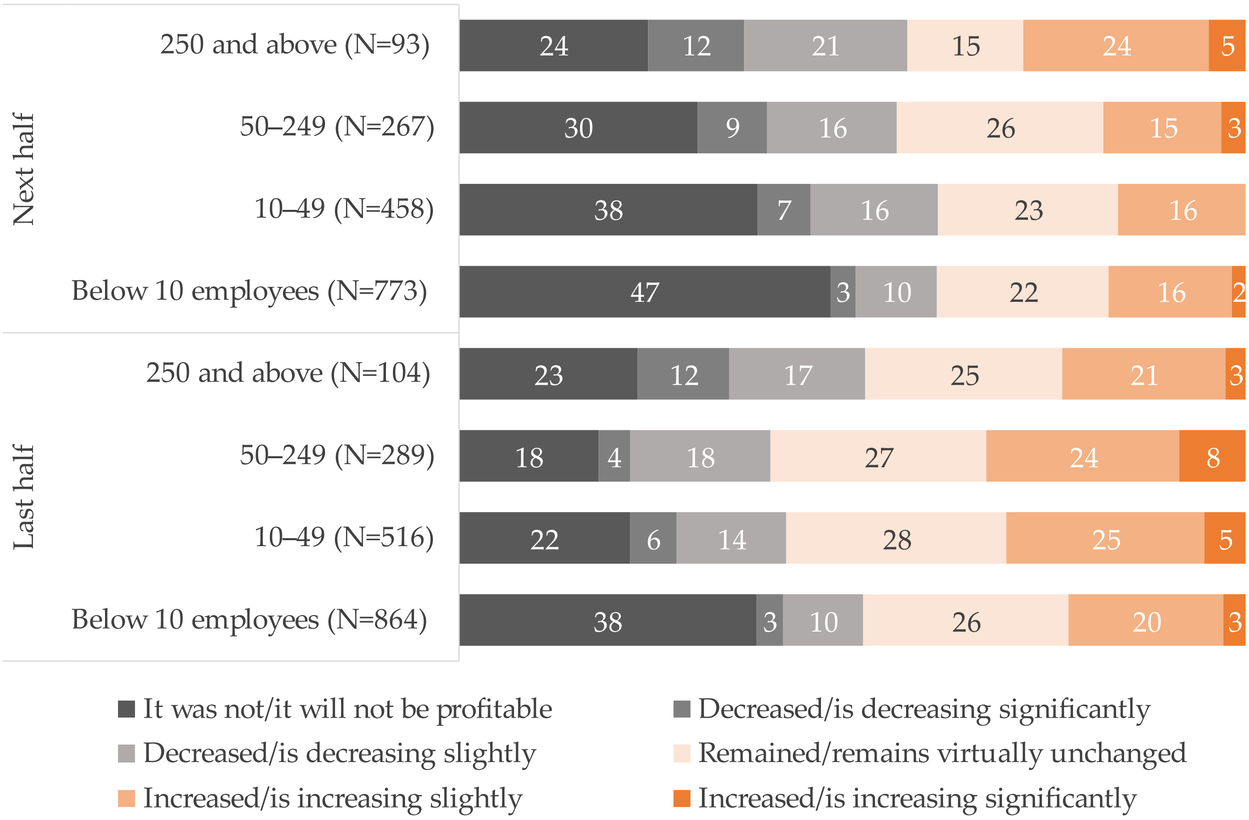
Note: Data weighted by the economic performance of companies

Differences by company size

Over the past six months, small enterprises with fewer than 10 employees and large, 250+ companies reported the highest rates of no profits or falling profitability, and they also produced the lowest rates of firms with mild profit growth (23% and 24% respectively).

In terms of expectations for the next six months, almost half of small businesses with fewer than 10 employees do not expect to make a profit, a proportion that decreases as the size of the business increases. Larger firms do not expect a complete absence of profits, but rather a decrease in profitability in the next six months compared to the same period in 2021. The proportion of small firms with fewer than 10 employees expecting a decline in profitability is 13 percent, compared to 23 percent for 10-49 companies, 25 percent for 51-249 companies and 33 percent for large firms with 250 or more employees. The 250+ group also have the lowest proportion of companies expecting no change in profitability (15%) and the highest proportion expecting an increase in profitability (29%). In other words, managers of 250+ firms have a much more polarised view of the future development of their profitability than managers of smaller firms, i.e. they expect either a decrease or an increase (Figure 2).

Figure 2: Profitability of the main activity of the enterprise by company size (percent)



Source: IEER 2022

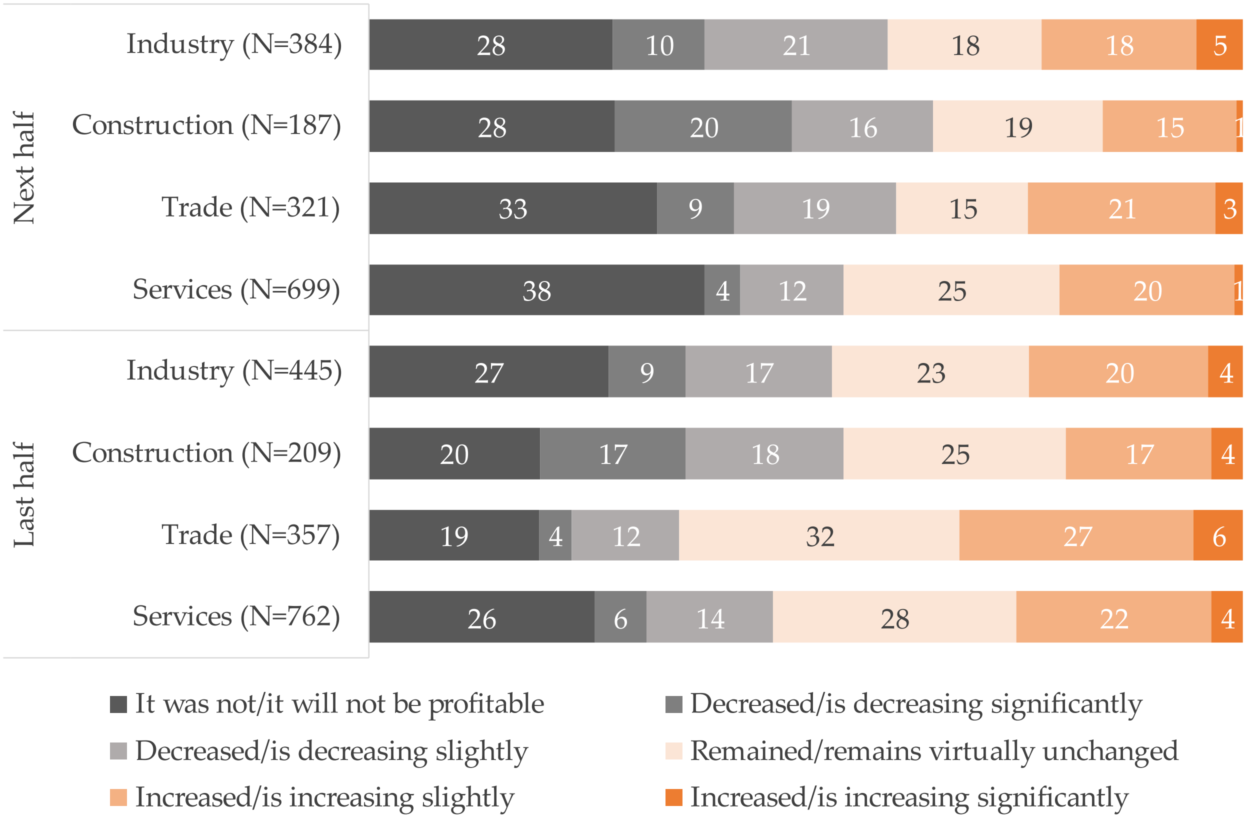
Note: Data weighted by the economic performance of companies

Differences by sector

Compared to the same period in 2021, trading companies were the most balanced in terms of profitability over the past six months. Almost a fifth of companies in this sector reported no profit, 16% reported a decrease in profitability, while 33% reported an increase. The more favourable situation of distributive trade firms is also due to the fact that 32% of them managed to maintain their profitability level of a year earlier. In the industrial and services sectors, the highest proportions of firms that did not make a profit in the last six months were in the industrial and services sectors (26 and 27% respectively). However, the situation of construction firms is the most unfavourable in terms of profitability, with 35% seeing a fall in profits, 25% no change and only 21% seeing an increase. These rates were 26%, 23% and 24% respectively for industrial firms and 20%, 28% and 26% respectively for service providers.

For the next six months—compared to the period from October 2021 to April 2022—the highest proportion of economic service providers do not expect any profit at all (38%), with a further 16% expecting profitability to decline, 25% expecting stagnation and 21% expecting an improvement. Construction firms are the least optimistic about their profits in the upcoming six months, mainly because they have the highest proportion of firms expecting no profits or a decline in profits (64%) and the lowest proportion expecting profits to rise (16%). Of industrial firms, 28% expect no profit, 31% expect profitability to fall, 18% expect no change and 23% expect an increase. For trading firms, these proportions are 33, 28, 15 and 24 percent respectively (Figure 3).

3. Figure 3: Profitability of the main activity of the enterprise by sector (percent)



Source: IEER 2022

Note: Data weighted by the economic performance of companies

Differences by exporting activity

In terms of exporting activity, the highest proportion of non-exporting firms (31%) reported a fall in profitability over the past six months, with 17% reporting a fall in profits. This sector displayed the lowest proportion of firms reporting an increase in profitability (22%) and the highest proportion of firms reporting stagnation (30%). The situation of minor exporters is more favourable in two respects. On the one hand, they have the lowest share of firms that were not profitable in the last six months (14%) and the highest share of firms reporting an increase in profits (32%). Adding to this, 30% of minor exporters reported a decrease in profits compared to the period between April and October 2021. The profitability of predominantly exporting companies fared worse, with 24 percent of non-profitable companies reporting a decrease in profitability in the last six months, while 27 percent reported a decrease and 26 percent reported an increase in profitability.

Compared to the experience of the previous half, managers of non-exporting and minor exporting firms are more pessimistic about their profitability for the next half. This is illustrated by the fact that, compared to data from the previous half, a significantly higher proportion of managers expect their firms to be unprofitable (42% and 22% respectively) and that profits will decrease (21% and 33%). At the same time. fewer CEOs expect profits to increase (19 % and 24 %). This also means that such businesses have a significantly higher proportion of CEOs expecting profitability to fall or remain below that of the previous six months, and a lower proportion expecting it to stagnate. By contrast, the future expectations major exporters are broadly in line with their past experience.

Differences by ownership structure

In terms of ownership structure, (partially) foreign-owned enterprises were in a significantly less favourable position in terms of profitability in the last six months than fully domestic enterprises. 27 percent of (partially) foreign-owned firms were not profitable in the past six months, with almost a third (29%) seeing a fall in profits, a quarter stagnating and five-fifths seeing an increase compared to the same period in 2021. By contrast, a quarter of fully domestic companies reported no profit in the last six months, 21% reported a fall in profitability, 28% reported stagnation and 28% reported an increase.

Compared with the previous six months, expectations for the future are more pessimistic for both groups of companies. This is reflected in the high proportion of (partially) foreign firms forecasting a fall in profits (36%) and in the high proportion of fully domestic companies forecasting a fall in profitability (36%). For the latter group, the proportion of those expecting profitability to increase (21%) is also significantly lower than those actually experiencing it in the previous half (28%). The share of those expecting no change in profit development is 16% for companies of (partially) foreign ownership and 21% for domestic firms, which indicates a significant decrease compared to the previous half.

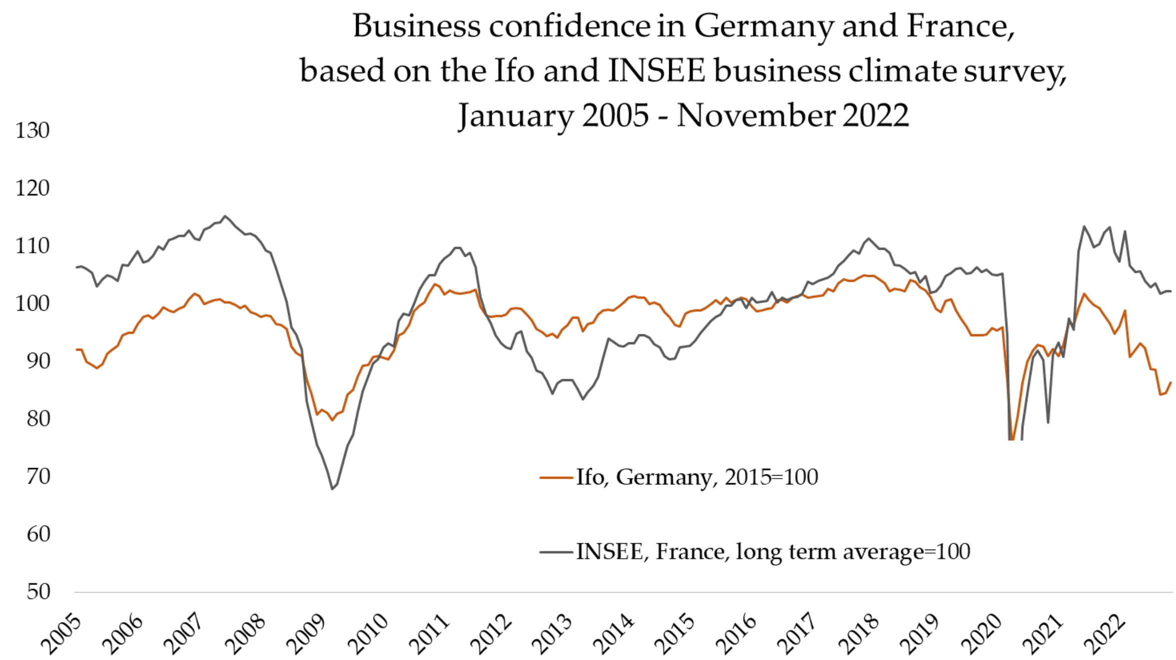
International trends

Changes in the production, consumption and employment situation in certain major international economies compared with peer expectations and the previous period.

		Period in review	Actual data	Expectations	Previous period
Germany	Unemployment Rate	(November)	**5.6%**	5.5%	5.5%
	Manufacturing Purchasing Managers Index	(November)	**46.2**	46.7	45.1
	IFO Business Climate Index[1]	(November)	**86.3**	80.0	84.5
France	INSEE Business Climate Index[2]	(November)	**102.2**		102.2
USA	Unemployment Rate	(November)	**3.7%**	3.7%	3.7%
	CB Consumer Confidence Index	(November)	**100.2**	100.0	102.2
	Manufacturing Purchasing Managers Index	(November)	**47.7**	47.6	50.4
China	Manufacturing Purchasing Managers Index	(November)	**48.0**	49.0	49.2

[1] https://www.ifo.de/en/survey/ifo-business-climate-index
[2] http://www.insee.fr/en/themes/indicateur.asp?id=105
The rest of the data source: https://www.bloomberg.com/markets/economic-calendar

In Germany, the IFO business climate index increased compared to October. The manufacturing purchasing manager index (PMI) also increased compared to the previous period and performed better than expected. The unemployment rate slightly worsened compared to the previous month in Germany. The French INSEE business climate index remained the same compared to last month. In the United States, the CB consumer confidence index decreased compared to the month prior. The manufacturing PMI also decreased compared to October in the USA. The unemployment rate remained the same in the USA. The Chinese manufacturing PMI decreased compared to the previous month.



Sources: www.ifo.de, www.insee.fr

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In case of publication please cite as follows:
HCCI-IEER: Monthly Bulletin of Economic Trends,
November-December 2022, Budapest,
2022-12-14